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Fitch, Moody's to Delay Recalibrations

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By Jack Herman

Fitch Ratings and Moody's Investors Service both said yesterday they will delay the proposed recalibrations of their U.S. municipal rating scales amid the recent turmoil in financial markets.

Fitch said it still plans to recalibrate its municipal ratings, but will defer its final decision on its methods until it "revisits" the issue during the first quarter of 2009. Following Fitch's announcement, Moody's said it had postponed the application of its shift to a global ratings scale after unveiling a schedule last month in which the first batch of credits would move by the end of October.

"The issue at hand is the appropriateness of the extent of recalibration contained in the exposure draft as well as the process for implementation," Robert Grossman, group managing director of public finance at Fitch, said in an e-mailed statement. "We will be studying whether constrained market access and the associated market turmoil have an impact on municipal credit quality overall, or for any particular subgroup."

"Conditions in the global credit markets continue to be unsettled," Gail Sussman, Moody's group managing director for U.S. public finance, said in a statement. "While Moody's remains committed to ensuring that our US public finance ratings are comparable to ratings in other sectors, we are sensitive to introducing a recalibration in the midst of current credit market turmoil."

As currently drafted, both plans would lead to higher ratings on many municipal credits even in the face of global economic uncertainty. In its exposure draft, Fitch said it expected 86% of state and local general obligation credits to be rated in the AA or AAA categories, compared to 58% on the current scale. Moody's said its preliminary analysis showed state and local GO credits would move an average of two notches higher under its shift to a global scale.

Given the threats facing municipal budgets, the delays are the "prudent thing to do," said Richard Ciccarone, managing director and chief research officer of McDonnell Investment Management LLC.

The current credit crisis and weakening economy only add to a list of many long-term pressures already facing governments, including pension, other post-employment benefit, and infrastructure costs.

"Now is not the time to put our heads in the sand and ignore all the conditions that are out there," Ciccarone said.

The current market conditions rank among the worst for municipal issuers in decades, he said. A study released yesterday by the Rockefeller Institute said "the damage is just beginning" on state budgets as a result of the current financial crisis.

But all the rating agencies have faced a backlash from issuers and politicians that say the ratings scales led to increased borrowing costs by systemically rating municipal credits lower than corporate credits with higher rates of default.

Connecticut Attorney General Richard Blumenthal sued the rating agencies in May for violating antitrust practices, for instance, and the House Financial Services Committee in July approved a bill that requires the rating agencies to use a single scale that is based on likelihood of repayment. Amid the broader financial crisis, it never reached the floor for a vote.

While Fitch and Moody's announced their plans for recalibrations, Standard & Poor's has asserted it always maintained just one scale for municipal and corporate debt. Earlier this year, though, the agency "re-benchmarked" credits due to a recent default study. It upgraded 604 state and local municipal credits in the second quarter, compared to an average of 87 per quarter since 1986.

This year, Standard & Poor's has made 1,195 upgrades compared to 114 downgrades, Moody's has made 323 upgrades compared to 131 downgrades, and Fitch has made 61 upgrades compared to 44 downgrades, according to data compiled by The Bond Buyer. The data is compiled from ratings actions published in The Bond Buyer's weekly table and takes into account each individual rating action, which means some credits may be double counted.

While some issuers have said they believe the upgrades will lead to lower borrowing costs, other market participants remain skeptical. They say the upgrades should have little effect on pricing, because the underlying credits and the risks they pose remain the same.